BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
ANGELUS INDUSTRIES, INC.)

Appearances:

For Appellant: Jack W. Nakell
Certified Public Accountant

Jack Rogers
Certified Public Accountant

For Respondent: David M. Hinman
Counsel

O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax.Board on the protest of Angelus Industries, Inc., against a proposed assessment of additional franchise tax in the amount of $7,070.00 for the income year ended December 31, 1969.

The sole issue presented is whether respondent's action in disallowing appellant's deduction of a partnership loss for the year 1969 was proper.

In 1965 appellant formed a partnership with another corporation and two individuals for the purpose of acquiring and developing certain real property located in California. Appellant contributed cash in the amount of $115,000 to the partnership capital in return for a 40 percent interest in the partnership and the right to withdraw the first $115,000 of partnership profits.

Early in 1966, after recovering $15,000 of its initial contribution to the partnership, appellant entered into a "subpartnership" agreement with Mr. Noel Levine. Following a brief account of the nature and extent of appellant's interest in the partnership, the "subpartnership" agreement provided:

> [I]t is agreed by and between the parties hereto that [appellant] agrees to sell to Levine a 12-1/2% participation in its interest in said partnership (5% of the whole) for the sum of Five Hundred Dollars ($500.00), paid at the time of the execution hereof.
>
> In addition thereto Levine agrees to purchase simultaneously herewith by assignment the interest of [appellant] in and to Fifty Thousand Dollars ($50,000.00) of said One Hundred Thousand Dollar ($100,000.00) capital contribution.
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> * * *
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> Maxwell L. Rubin, President of [appellant] hereby personally guarantees to Levine that [appellant] will hold said interest in trust for and for the benefit of Levine and that [appellant] will immediately upon receipt of any sums distributed by said partnership pay over and deliver to Levine any and all sums that may be due Levine under the terms of this Subpartnership agreement ....

Simultaneously with the execution of the above agreement, appellant entered into a separate but identical "subpartnership" agreement with Mr. A. Hershson. Thus, in consideration of their payment of $1,000 to appellant, Messrs. Levine and Hershson acquired 25 percent of appellant's 40 percent interest in the partnership's profits

and losses; in consideration of their payment of $100,000 to appellant, Messrs. Levine and Hershson'acquired appellant's right to receive the next $100,000 of partnership profits.

Ultimately, the partnership venture proved unsuccessful and the partnership was terminated at the end of 1969. On its final return, the partnership reported a net loss of $148,303. On its own return for 1969, appellant claimed a deduction in the amount of $113,817 as its distributive share of the partnership loss..

Section 17858 of the Revenue and Taxation Code provides that a "partner's distributive share of partnership loss (including capital loss) shall be allowed only to the extent of the adjusted basis of such partner's interest in the partnership at the end of the partnership year in which such loss occurred." After conducting an audit of appellant's 1969 return, respondent determined that the adjusted basis of appellant's partnership interest at the end of 1969 was equal to zero. Accordingly, pursuant to section 17858, respondent disallowed the $113,817 partnership loss claimed by appellant.

In computing the final adjusted basis of appellant's partnership interest, respondent treated the "subpartnership" transactions as a sale of appellant's interest in the capital of the partnership. Thus, respondent reduced the basis by $100,000 to reflect appellant's receipt of that amount pursuant to the sale. 1/ Appellant, on the other hand, contends that the $100,000 received from Messrs. Levine and Hershson represented a loan. Apparently, it is appellant's position that the "subpartnership" transactions were intended to create a debtor-creditor relationship between the parties and, therefore, that the transactions should have no bearing on the computation of the final adjusted basis of its partnership interest.

1/ Since appellant had recovered $15,000 of its original $115,000 contribution to the partnership, the adjusted basis of its partnership interest immediately prior to execution of the "subpartnership" agreements was equal to $100,000. (See Rev. & Tax. Code, §§ 17860, 17'882.) Appellant's sale of its interest in the capital of the partnership for $100,000 required further reduction of the adjusted basis to zero. (See Rev. & Tax. Code, §§ 17901, 18052.)

In support of its position that the $100,000 received from Messrs. Levine and Hershson represented a loan, appellant has presented evidence that its president personally guaranteed repayment of the $100,000 and that the president repaid the purported loan subsequent to the partnership's termination. Ordinarily, however, a debt is represented by "an unqualified obligation to pay a sum certain at a reasonably close fixed maturity date along with a fixed percentage of interest payable regardless of the debtor's income or lack thereof." (Gilbert v. Commissioner, 248 F.2d 399, 402 (2d Cir. 1957).) In view of the complete absence of these recognized indicia of indebtedness, we find the evidence that appellant's president personally guaranteed reimbursement of the $100,000 investment insufficient to establish the existence of a bona fide debtor-creditor relationship between appellant and Messrs. Levine and Hershson. Furthermore, the clear language of the "subpartnership" agreements indicates that appellant assigned its interest in the capital of the partnership to Messrs. Levine and Hershson in return for the $100,000 payment, and that appellant's president merely guaranteed distribution to Messrs. Levine and Hershson of the future partnership profits received by appellant. Thus, while there is little evidence in the record to support appellant's claim that the $100,000 payment represented a loan, there is ample evidence to support respondent's determination that the "subpartnership" transactions constituted a sale of appellant's capital interest in the partnership.

Respondent's computation of the adjusted basis of appellant's partnership interest is presumed to be correct; the burden rests with appellant to prove otherwise. (M. Pauline Casey, 38 T.C. 357, 372 (1962); J. Thomas Requard, 66,141 P-H Memo. T.C. (1966).) On the basis of the record before us, we must conclude that appellant has failed to sustain its burden of proving that the adjusted basis of its partnership interest at the end of 1969 exceeded the amount determined by respondent. Accordingly, respondent's action in this matter must be sustained.

Anneal of Anqelus Industries, Inc.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Angelus Industries, Inc., against a proposed assessment of additional franchise tax in the amount of $7,070.00 for the income year ended December 31, 1969, be and the same is hereby sustained.

Done at Sacramento, California, this 5th day of December, 1978, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member